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C O N F I D E N T I A L SECTION 01 OF 05 LAGOS 000750

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TREASURY FOR ASEVERENS, SRENENDER, DFIELDS
COMMERCE FOR KBURRESS
DOE FOR GPERSON, CGAY
STATE PASS USTR FOR ASST USTR FLISER
STATE PASS TRANSPORTATION FOR MARAD
STATE PASS OPIC FOR ZHAN AND MSTUCKART
STATE PASS TDA FOR NCABOT
STATE PASS EXIM FOR JRICHTER
STATE PASS USAID FOR GWEYNAND AND SLAWAETZ

E.O. 12958: DECL: 10/31/2017
TAGS: EPET ENRG PGOV NI
SUBJECT: A POSSIBLE STRUCTURE FOR A NEW NIGERIAN OIL SECTOR

REF: A) LAGOS 000602 B) LAGOS 000697 C) LAGOS 000717

LAGOS 00000750 001.2 OF 005

Classified By: Acting Consul General Vicki Hutchinson for reasons 1.4 (B) and (D)

¶1. (SBU) Summary: This cable provides an initial view of plans by the government of Nigeria (GON) to reorganize its petroleum sector and national oil company. No official plan has been announced publicly. Clarification may come in February 2008, but the actual implementation is expected to take significantly longer. Nigeria faces serious challenges in reforming the state oil company and its petroleum sector in general. End Summary.

The New Nigerian Petroleum Sector?

¶2. (SBU) In August 2007, Nigeria's President Umaru Yar'Adua announced that the Nigeria would reorganize its national oil company within six months (Ref A). The details on the organization outlined below come from information gleaned from press reports, statements from contacts, and a draft, untitled, reorganization plan obtained from an industry executive. The document is being circulated among industry executives for comment and is believed to be the basis for current reform planning. The committee tasked with reform planning has not made its work public.

¶3. (SBU) This is not an exhaustive or final description of the reorganization. Details are sketchy and information is occasionally contradictory. The roles of some of the new entities appear to overlap and are often vague. As is often the case in Nigeria, there may be a disconnect between the organization as presented on paper and the organization as it really functions. Of particular interest is the fate of National Petroleum Investment Management Service (NAPIMS),

the NNPC unit that controls Nigeria's joint ventures with the international oil companies (IOCs).

Minister of Petroleum Resources (MPR)

¶4. (SBU) MPR will perform ministerial level functions for the government of Nigeria within the oil and gas sector.
Specific responsibilities include:
--Advising the President and Federal Executive Council on oil and gas issues;
--Administering the sectors through strategies developed by its policy division;
--Overseeing and coordinating the entities listed below and;
--Representing Nigeria at OPEC and other international petroleum forums.

National Petroleum Directorate (NPD)

¶5. (SBU) The NPD will work directly for the Minister as a policy formulation group. Its mandate is to maximize Nigeria's economic return from its oil and gas resources. It will not develop technical regulations or licensing requirements.
Specific responsibilities include:
--Creating sector policies and strategies;
--Optimizing the government's interests in petroleum agreements;
--Developing the oil and gas sectors in general, including policies to increase reserves and;
--Acting as custodian of unassigned oil blocks and deciding when those blocks should be allocated for production.

¶6. (SBU) The bidding process for unassigned acreages released by NPD will be managed by the Petroleum Inspectorate Commission described in the following section.

Petroleum Inspectorate Commission (PIC)

¶7. (SBU) PIC will act as an upstream and downstream regulator, a licensing body, and in some respects a tax authority. It will combine the functions of the current Department of Petroleum Resources (DPR) with certain NNPC activities. Specific responsibilities in the exploration and production sectors include:
--Processing applications for acreage allotments;
--Evaluating reserves and managing reservoirs;
--Administrating leases;
--Collection of royalties, rentals, and fees;
--Establishing and enforcing safety and performance standards;
--Ensuring compliance with all petroleum laws and regulations and;
--Publishing sector reports and statistics.

¶8. (SBU) PIC responsibilities in the natural gas and downstream oil sectors include:
--Licensing new companies to operate in the downstream markets;
--Licensing new investment projects;
--Creating and enforcing regulations on wholesale and retail sales, marketing, and transportation of petroleum products;
--Enforcing local content laws in downstream activities and;
--Conducting environmental impact assessments for new investment projects.

¶9. (SBU) PIC responsibilities in health and safety will include:
--Establishing standards for facility designs and operations;
--Establishing safety, health, and environmental standards

that comply with national and international norms and;
--Ensuring compliance with the above standards.

¶10. (SBU) PIC will be funded through a levy on all crude oil and condensate produced in Nigeria. Additionally, it will receive a portion of the funds accruing to the Petroleum Technology Development Fund.

The National Oil Company (NOC)

¶11. (SBU) The NOC will be a fully integrated upstream and downstream petroleum company. NNPC's current oil exploration arm, the Nigerian Production and Development Company (NPDC), the Nigerian Gas Company, and the Petroleum Products Marketing Company will be combined with four oil refineries to make up the new NOC. The NOC will operate in the following areas:
--Exploration and production of oil and natural gas;
--Oil refining;
--Refined products marketing and sales;
--Natural gas and liquid propane gas production, marketing and sales;
--Research and development and;
--Operation of other petrochemical plants.

¶12. (SBU) The NOC will have an independent board of directors. However, the appointment and removal of the NOC's chief executive officer will be subject to Senate approval. In theory, it will be an economically viable company. The NOC will bid for projects competitively with the IOCs, but for reasons of "national interest" may be "assigned choice acreages" by Nigerian authorities. Initial operating and capital funds will be provided by the Government of Nigeria

(GON). Additionally, the NOC will be granted a percentage of the national reserves to provide it with assets to use as a basis for obtaining private financing.

Petroleum Products and Distribution Authority (PPDA)

¶13. (SBU) The PPDA is the successor to the Petroleum Products Pricing Regulatory Agency, a government regulator and pricing authority. It is in theory responsible for setting retail gasoline prices. In practice the establishment of those prices has been a political decision made at highest levels of the Nigerian government. Primary responsibilities of the PPDA include:
--Co-coordinating and regulating all commercial activities in the downstream oil and gas industry;
--Determining pricing policies for petroleum products;
--Setting benchmarks for downstream natural gas pricing;
--Regulating the supply and distribution of petroleum products;
--Moderating volatility in product prices while ensuring a reasonable return to operators;
--Establishing parameters and codes of conduct for all operators in the downstream market;
--Regulating refineries and;
--Regulating common carrier oil and gas pipeline regimes.

National Petroleum Research Center (NPRC)

¶14. (SBU) NPRC will act at the Nigerian government's petroleum and research institution. It will not have a regulatory or standards setting function. Primary duties include:
--Conducting research along the petroleum value chain;
--Conducting valuations of petroleum fields for the Nigerian government;

--Collaborating with PIC to analyze and evaluate information received from the IOCs;
--Developing, patenting, and marketing new technologies;
--Conducting environmental impact assessments and;
--Carrying out other industry research, investigations and projects as required.

Who Gets (Stuck With) the Joint Ventures?

¶15. (SBU) The fate of the National Petroleum Investment Management service, NAPIMS, and the joint ventures it controls, is of particular concern. Questions about where it ends up and the form it takes are probably driving much of the current reorganization planning.

¶16. (SBU) Nigeria uses two different types of petroleum contracts. More recent agreements for deep water exploration and production use production sharing contracts (PSCs). However, much of Nigeria's onshore and shallow offshore oil production is done through older, unincorporated joint venture agreements. The GON, through NNPC, participates in these agreements as a majority, non-operating partner. Like the other venture partners, it is subject to periodic cash calls for funds to develop and continue production. However, Nigeria is routinely late and short in providing its share of these funds (Ref C). This has been a great source of frustration for the IOCs and has hampered sector development, particularly of associated natural gas gathering projects. The GON would like to rid itself of these cash call obligations. In addition to being a financial burden, the GON believes this issue is used by the IOCs as an excuse not to invest further in onshore oil and gas projects. It is an

excuse the GON has a hard time countering.

¶17. (SBU) Several possible destinations for NAPIMS have surfaced. The draft plan received by Post shows NAPIMS and the joint ventures falling under the PIC, and hence remaining the responsibility of the Nigerian government. Press reporting and an NNPC source tell a similar story, but with NAPIMS as an independent governmental agency called the National Oil and Gas Asset Management Company. In contrast, a senior level contact at DPR has said that NAPIMS and the joint ventures will be turned over to the NOC and the government would be relieved of all responsibility for them (Ref B).

¶18. (C) Recent developments indicate that Nigeria is rethinking the joint ventures entirely. One presidential advisor caused a stir in the media when he said Nigeria was going to rethink its agreements with the IOCs. Dr. O Emanuel Egbogah, the President's top advisor on petroleum, clarified that statement. He told Post that Nigeria plans to restructure the joint ventures by incorporating them. This is most likely an attempt to give the joint ventures a structure that eliminates the need for cash call payments (Ref C). In that case, NAPIMS and the joint ventures could be given to the NOC as part of its initial capitalization without the burden of negative cash flows to the joint ventures.

¶19. (C) IOC reaction to the reorganization has been mixed. While our oil company contacts agree that some reorganization is needed, they are also skeptical that a new NOC will be a viable company. Oil executives believe that a reorganization will take significantly longer than Nigerian officials expect, and they fear that in the short and medium term, NNPC and its successor will be even more chaotic and difficult to deal with than usual. IOC representatives also agree that NNPC is currently paralyzed by the uncertainty surrounding the reorganization. Executives from Shell, Chevron, Exxon Mobil, Total, Schlumberger, Halliburton, and Conoco Phillips all say the same thing; as it stands now, NNPC is a blackhole

of work. New contracts are being delayed and expenditures are not being approved. It is thought that inside NNPC, executives with the authority to make decisions are jockeying for position in a reorganized entity and have lost focus on current operations.

Comment

¶20. (C) Reports of paralysis at NNPC and prospects for continued confusion are troubling. Nigeria faces many critical investment decisions in the next 12 to 18 months, including construction of two new liquefied natural gas terminals and expansion of a third, commencement of gas flow through the West African Gas Pipeline, repair of its four refineries, and construction of numerous independent power projects. These decisions come at a time of rising costs due to increased worldwide demand for petroleum industry services. Further indecision will prove costly, delaying revenues and diverting needed money from social spending and non-petroleum related infrastructure.

¶21. (C) Statements by Nigerian officials that the NOC will resemble Brazil's Petrobras or Saudi Aramco are wildly optimistic. While NNPC does not publish audited financial statements that would allow for a detailed analysis, there are well known deficiencies in its operations. Its production unit, NPDC, lifts about 70,000 barrels per day. The nation's four refineries suffer from a lack of maintenance and an intermittent supply of feedstock. In general, NNPC is poorly managed, extremely bureaucratic, and corrupt. The hiring of outside Nigerian petroleum executives

with IOC experience would be a sign that Nigeria is serious about NNPC reforms.

¶22. (U) This cable has been coordinated with Embassy Abuja.
HUTCHINSON